Macroeconomic Policy
Macroeconomic Policy

Growing output and employment are the preconditions for progress in almost all social and economic aspects of development. Productive employment and rising incomes for the vast majority over a long period can do more to combat poverty decisively than any direct assistance government can ever provide.

It is private actors – from the smallest self-employed entrepreneurs to the largest conglomerates – that create productive jobs and incomes. Government’s responsibility however – through fiscal and monetary policies – is to create an environment for vigorous economic activity, as well as to ensure that enough gains from growth are set aside for larger social purposes or channelled into social investments that facilitate future growth. These objectives are achieved by government decisions regarding the size and direction of public spending and taxation (fiscal policy) and by decisions regarding the control of the nation’s money supply (monetary policy).

Output and Employment

Economic Performance 2004-2010

GDP growth averaged 5.6 percent for the period 2004–2006, while average GNP growth was higher at 5.9 percent, boosted by transfers from overseas workers. On the demand side, private consumption (which comprises about 70% of GDP), grew an annual average of 5.4 percent. Merchandise exports grew at an average of 9.4 percent, while exports of non-factor services (which included BPOs such as back office payroll or accounting and call centers) registered an average of 20.6 percent.

Figure 2.1 Contributions to Growth (Demand): 2004-2010

Source: NSCB
Capital formation, on the other hand, averaged 1.1 percent growth per year during the period (Table 2.1). Overall, consumption fuelled by remittances is the largest and most stable source of growth from the demand side. The contribution of net exports (including BPO), although volatile, was also positive. Investment made a small positive contribution in 2004 and 2006, but contributed negatively in 2005. The contribution of public consumption to growth has been marginal (Figure 2.1).

On the supply side, the largest contribution to growth consistently came from the services sector, followed by the industry sector. The agriculture sector, which is vulnerable to changes in weather patterns, managed to make a small positive contribution to growth during the period (Figure 2.2).

Average growth was relatively modest, owing to the economy’s vulnerability to a number of domestic and external shocks. The continued US-led war on terrorism, accompanied by the escalating prices of petroleum and sluggish demand for electronics dragged down economic activities in 2005. Domestically, political factors were partly responsible for compelling the government to run under reenacted budgets. The relatively low inflation in 2002-2003 was followed by upward price pressures in 2004 due to geopolitical tensions in the Middle East and growing resource demands from China and India, all of which contributed to a surge in world oil prices.

The economy expanded at its fastest rate in three decades in 2007, with GDP growing at 7.1 percent (and GNP growing at 7.4%). With greater fiscal space from the previous year’s tax reforms, and with spending ahead of national elections, public construction rose 29.1 percent. Private construction likewise grew 13.3 percent, boosted by remittance-fuelled residential construction as well as the need for more supply of office space. Overall, capital formation grew 12.4 percent, up from the 5.1-percent growth of a year ago and the 8.8-percent contraction two years previously. Likewise, private consumption, which constitutes the largest proportion of GDP on the expenditure side, continued its stable growth at 5.9 percent, fuelled by...
### Table 2.1 Philippine Key Indicators

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tr>
<td>GNP</td>
<td>6.9</td>
<td>5.4</td>
<td>5.4</td>
<td>7.5</td>
<td>6.4</td>
<td>4.0</td>
<td>7.2</td>
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<tr>
<td>GDP</td>
<td>6.4</td>
<td>5.0</td>
<td>5.3</td>
<td>7.1</td>
<td>3.7</td>
<td>1.1</td>
<td>7.3</td>
</tr>
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<td>Agriculture</td>
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<td>2.0</td>
<td>3.8</td>
<td>4.9</td>
<td>3.1</td>
<td>0.0</td>
<td>-0.5</td>
</tr>
<tr>
<td>Industry</td>
<td>5.2</td>
<td>3.8</td>
<td>4.5</td>
<td>6.8</td>
<td>4.9</td>
<td>-0.9</td>
<td>12.1</td>
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<tr>
<td>Mining</td>
<td>2.6</td>
<td>9.3</td>
<td>-6.1</td>
<td>26.0</td>
<td>1.9</td>
<td>21.5</td>
<td>18.4</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5.8</td>
<td>5.3</td>
<td>4.2</td>
<td>3.3</td>
<td>4.2</td>
<td>-4.4</td>
<td>12.3</td>
</tr>
<tr>
<td>Construction</td>
<td>3.4</td>
<td>-5.9</td>
<td>9.6</td>
<td>21.0</td>
<td>7.6</td>
<td>9.8</td>
<td>10.5</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water</td>
<td>4.2</td>
<td>2.5</td>
<td>6.4</td>
<td>6.7</td>
<td>7.3</td>
<td>-2.9</td>
<td>8.5</td>
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<tr>
<td>Electricity &amp; Gas</td>
<td>4.3</td>
<td>2.5</td>
<td>6.2</td>
<td>6.7</td>
<td>7.6</td>
<td>-3.5</td>
<td>8.8</td>
</tr>
<tr>
<td>Services</td>
<td>7.7</td>
<td>7.0</td>
<td>6.5</td>
<td>8.1</td>
<td>3.1</td>
<td>2.8</td>
<td>7.1</td>
</tr>
<tr>
<td>Personal Consumption</td>
<td>5.9</td>
<td>4.8</td>
<td>5.5</td>
<td>5.8</td>
<td>4.7</td>
<td>4.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Government Consumption</td>
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<td>2.3</td>
<td>10.4</td>
<td>6.6</td>
<td>0.4</td>
<td>10.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Capital Formation</td>
<td>7.2</td>
<td>-8.8</td>
<td>5.1</td>
<td>12.4</td>
<td>2.3</td>
<td>-5.7</td>
<td>17.0</td>
</tr>
<tr>
<td>Fixed Capital</td>
<td>1.3</td>
<td>-6.6</td>
<td>3.9</td>
<td>10.9</td>
<td>2.7</td>
<td>-0.4</td>
<td>17.1</td>
</tr>
<tr>
<td>Construction</td>
<td>-0.8</td>
<td>-7.3</td>
<td>7.6</td>
<td>19.5</td>
<td>4.2</td>
<td>7.4</td>
<td>12.0</td>
</tr>
<tr>
<td>Public Construction</td>
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<td>-18.0</td>
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<td>29.1</td>
<td>-1.3</td>
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<td>3.7</td>
</tr>
<tr>
<td>Private Construction</td>
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<td>-1.1</td>
<td>-3.7</td>
<td>13.3</td>
<td>8.2</td>
<td>-2.8</td>
<td>19.1</td>
</tr>
<tr>
<td>Durable Equipment</td>
<td>3.2</td>
<td>-7.1</td>
<td>1.3</td>
<td>4.5</td>
<td>1.9</td>
<td>-8.2</td>
<td>25.7</td>
</tr>
<tr>
<td>Changes in Stocks</td>
<td>-444.1</td>
<td>-58.1</td>
<td>64.1</td>
<td>57.5</td>
<td>-7.5</td>
<td>-139.8</td>
<td>-356.1</td>
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<tr>
<td>Changes in Stocks (% of capital formation)</td>
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<td>1.9</td>
<td>3.0</td>
<td>4.3</td>
<td>3.8</td>
<td>-1.6</td>
<td>-5.6</td>
</tr>
<tr>
<td>Exports</td>
<td>15.0</td>
<td>4.8</td>
<td>13.4</td>
<td>5.5</td>
<td>-2.0</td>
<td>-13.4</td>
<td>25.6</td>
</tr>
<tr>
<td>Merchandise Exports</td>
<td>12.9</td>
<td>4.2</td>
<td>11.3</td>
<td>4.1</td>
<td>-1.7</td>
<td>-16.8</td>
<td>26.0</td>
</tr>
<tr>
<td>Non-Factor Services</td>
<td>28.8</td>
<td>8.3</td>
<td>24.7</td>
<td>12.3</td>
<td>-3.0</td>
<td>2.3</td>
<td>24.3</td>
</tr>
<tr>
<td>Imports</td>
<td>5.8</td>
<td>2.4</td>
<td>1.8</td>
<td>-4.1</td>
<td>0.8</td>
<td>-1.9</td>
<td>20.7</td>
</tr>
<tr>
<td>Merchandise Imports</td>
<td>6.2</td>
<td>2.1</td>
<td>1.3</td>
<td>-5.6</td>
<td>0.1</td>
<td>-1.8</td>
<td>20.2</td>
</tr>
<tr>
<td>Non-Factor Services</td>
<td>-1.4</td>
<td>8.5</td>
<td>11.0</td>
<td>20.9</td>
<td>9.9</td>
<td>-3.6</td>
<td>26.3</td>
</tr>
<tr>
<td>Unemployment (in percent)</td>
<td>11.8</td>
<td>8.7</td>
<td>8.0</td>
<td>7.3</td>
<td>7.4</td>
<td>7.5</td>
<td>7.3</td>
</tr>
<tr>
<td>Underemployment (in percent)</td>
<td>17.6</td>
<td>21.0</td>
<td>22.6</td>
<td>20.1</td>
<td>19.3</td>
<td>19.1</td>
<td>18.7</td>
</tr>
</tbody>
</table>

Sources: NSCB; Labor Force Statistics Yearbook; DOLE-LFS
Note: The 2005 unemployment rate data may not be consistent due to the adoption of a new unemployment definition in the April 2005 round LFS.
remittances from overseas workers (Table 2.1).

On the production side, the services sector continued to be the largest contributor to growth. The industry sector, with unprecedented growth rates from mining (at 26.1%) and construction (21%) sectors, contributed higher more to GDP growth as compared with the previous three years (Table 2.1 and Figure 2.2). Agriculture, with help from the better weather compared to the past two years, also had a higher contribution to GDP than in the past two years (Figure 2.2).

Price pressures toward the middle part of 2008 (Figure 2.10) - on account of rising world prices of grains and petroleum, as well as the global recession affecting the country through the trade channel towards the later part of the year, contributed to the slowdown of GDP growth to 3.7 percent (GNP growth was 6.4% for the year). As early as the start of 2008, it was clear the US would experience a recession and that the impact would reach the Philippines (in fact the Philippine stock index already fell 9.8% month-on-month in January 2008 and electronic exports contracted 6.5% in August 2008). It was not until close to the bottom of the crisis that policy rates were cut (on December 18, 2008) and the fiscal stimulus bared (in January 2009) This, although the inflation had been headed down since September 2008.

Monetary and fiscal stimuli came somewhat late. Overall, there was a noticeable slowdown in private consumption, and in government construction and consumption, and a contraction in exports during the year. On the production side, agriculture, industry, and services all slowed down.

The brunt of the global crisis was felt in the first half of 2009 when merchandise exports registered an average decline of 23.4 percent per quarter, caused largely by the contraction of electronics and garments exports. Furthermore, although government consumption and construction increased in the second quarter, the effects of the fiscal stimulus were blunted by the impact of two typhoons that hit the country in September-October 2009. Notwithstanding the effects of the global financial crisis, GDP in 2009 rose by 1.1 percent, a figure within the target of 0.8-1.8 percent, making the Philippines one of the few economies in the region to register positive performance amidst the recession.

Figure 2.3 Contributions to Growth (Demand): Quarterly, 2008-2010

![Figure 2.3 Contributions to Growth (Demand): Quarterly, 2008-2010](image)

Source: NSCB
financial crisis, GDP in 2009 rose by 1.1 percent, a figure within the target of 0.8-1.8 percent, making the Philippines one of the few economies in the region to register positive performance amidst the recession. GNP on the other hand, grew by 4 percent, fuelled by robust inflows of overseas remittances.

In 2010, coming from a low base and boosted by the rebound in world trade, quarterly GDP grew 7.3 percent. Remittance-driven consumption and the pick-up in investments and net exports (from significant negative contributions in 2009) boosted growth (Figure 2.3). On the supply side, the strong reversal of industrial performance (from negative contributions to growth in 2009), and the continued significant contribution of the services sector, drove the growth (Figure 2.4). Higher growth, however, was constrained by the negative impact of El Niño on agriculture and fisheries. Meanwhile, real GNP expanded by 7.9 percent as growth in net factor income from abroad eased to 10.3 percent from 31.6 percent in the same period in 2009. A significant part of the high growth in 2010 was clearly due to a recovery from a low base, implying that these growth rates cannot be expected to continue in 2011 and beyond without structural changes in the economy. Such structural changes are needed even more to achieve this Plan’s goal of a 7 to 8-percent annual growth rate in GDP.

**Employment and Poverty**

Increased globalization and faster economic growth have provided opportunities for Filipinos entering the labor market. Using the old concept of unemployment on which the Plan targets were based, unemployment rate improved from 11.9 percent in 2004 to 11.4, 11.1 and 10.8 percent in 2005, 2006 and 2007, respectively, lower than the Plan targets. Using the new International Labor Organization (ILO)-based methodology recently adopted by the country, unemployment stood at 8 percent in 2006, 7.3 percent in 2007 and 7.4 percent in 2008 (Figure 2.5). Despite these improvements, however, unemployment remains high in comparison with the country’s Asian neighbors (Figure 2.6) and meeting job creation targets continued to be a challenge.

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1 The DOLE started using the ILO-based definition in the April 2005 round of the Labor Force Survey (LFS) thus making it difficult to compute the FY2005 unemployment rate.
Figure 2.5 Philippines Unemployment Rate: 2006-2010 (in percent)

Sources: NSO, LFS

Figure 2.6 Comparative Unemployment Rates in Selected Asian Economies: 2006-2010

Sources: NSO, LFS; http://www.tradingeconomics.com.
* latest available data

Figure 2.7 Employment Generated: 2005-2010 (in ‘000)

Sources: NSO, LFS
The economic slowdown in 2008 affected the manufacturing sector and resulted in a net employment generation of only 530,000 net compared to the 771,000 yearly average for the period 2005-2007. The manufacturing sector in particular registered a negative net employment generation of about 134,000. In 2009, employment in both agriculture and manufacturing sectors remained sluggish. During that year, the services sector accounted for about 94 percent of the total 972,000 new jobs generated. (Figure 2.7).

With strong export and industrial performance in 2010, the economy showed some improvement on the labor front. In the October round of the 2010 LFS, the unemployment rate stayed at 7.1 percent, bringing the 2010 full-year average unemployment rate to 7.3 percent, lower than the 7.5 percent recorded in 2009. New jobs generated for the year were estimated at around 983,000, slightly more than in the previous year. Average underemployment in 2010 likewise improved to 18.7 percent from the previous 19.1 percent. While the LFS results indicated an improved employment situation, underemployment was still relatively high. In addition, the employment share of unpaid family workers and part-time workers stood at 11.5 percent and 35.2 percent, respectively, which suggests there is great room for improving employment conditions in the country.

Given the high underemployment rate of about 20 percent, it is not surprising to find a relatively high percentage of own-account workers (averaging 35.7%) among Filipinos. This partly reflects the difficulty of gaining employment in the formal labor market and implies a high incidence of informal sector work. In addition, the 43.2-percent “educated unemployed” out of the total unemployed labor force is also very high, a symptom of the labor mismatch in the country and a
factor contributing to the growing deployment of Filipino workers overseas, averaging about 1.1 million per year.

In the labor and employment sector, therefore, the policy challenge is to increase decent and productive employment and to enhance inclusive job-rich growth. To achieve this goal, the country can pursue supply-side strategies (such as enhancing the human resource base), as well as demand-side approaches (such as enhancing the returns to human and physical or entrepreneurial capital).

**Supply-side measures**

Working people are not simply the beneficiaries of growth but also its creators and drivers. Just as increases in employment and labor productivity contribute to economic growth, so too investments in the development of human resources help provide a foundation for a job-rich growth and development strategy. Qualities such as education, skills, health, and cognitive abilities help determine an individual’s ability to obtain productive employment, as well as expand the scope of labor productivity and pace of technological advancement of the country. Inclusive growth thus requires a special focus on the working poor and the unemployed, who comprise a significant portion (43%) of the labor force.

**Demand-side approaches**

Earnings and employment will depend on the rate, quality, and distributional aspects of economic growth. The rate of economic growth determines the extent of employment opportunities. Inclusive growth, in particular, must mean a higher and broad-based demand for labor and therefore more employment opportunities. This is important, considering the persistent unemployment and underemployment levels in the country. The sheer volume of workers working temporarily overseas\(^2\) indicates

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\(^2\) About one million OFWs are deployed per year, with their remittances accounting for at least 9.5 percent of GNP in 2009.
the lack of employment opportunities and suggests that domestic investments and entrepreneurship are being held back. These constraints need to be addressed along with strategies formulated to ensure that the working poor and the unemployed can participate and benefit from the development process.

A lack of gainful and quality employment opportunities is an important reason why poverty incidence in 2006 went up to 21.1 percent from 20.0 percent in 2003 (Table 2.2) and essentially stagnated between 2006 and 2009.

Disaggregated data also shows that across the different regions of the country, poverty incidence among families generally increased, with Regions Caraga, 9 and 8 posting more than 2 percentage points increases between 2006-2009. The regions of Caraga (39.8%), ARMM (38.1%), Bicol (36.0%), Eastern Visayas (33.2%), Northern Mindanao (32.8%), and Central Visayas (30.2%) also registered more than 30 percent poverty incidence while NCR had the lowest estimated poverty incidence of 2.6 percent. For the period 2003-2009, the geographical distribution of poverty remained unchanged being consistent in Caraga, Zamboanga Peninsula, Bicol and ARMM (Figure 2.9).

The regional distribution poverty also highlights the large variations in family income across the country. Most of the regions in Luzon had relatively lower proportion of families living below the poverty threshold than those living in Mimaropa, Bicol, Visayas and Mindanao regions. The lower poverty incidence in NCR and Regions 1, 2, 3 and 4-A can be attributed to higher access to employment opportunities and basic social services, while armed conflict and peace and order problems resulted in higher poverty incidence in Mindanao.
**Fiscal and Monetary Sectors**

Sound fiscal and monetary policies that foster macroeconomic stability are crucial to achieving sustained economic growth. A sustainable fiscal balance helps the country avoid boom-bust cycles that disrupt the pace of economic growth. Appropriate levels of fiscal deficits also allow the government to continuously support critical social programs and infrastructure projects. Prudent and responsible monetary policy that achieves low and stable inflation, in turn, gives both consumers and businesses a chance to plan over a longer time horizon. At the same time, it helps ensure that financial markets are stable and credit conditions are appropriate to support the continuous expansion of economy.

This section thus addresses the issues of macroeconomic stabilization. Performance and challenges in the fiscal and the monetary or external sectors are first addressed. Strategies that need to be adopted to achieve macroeconomic stabilization are then outlined.

**Assessment and Challenges**

**Fiscal Sector**

In 2004-2009, the government implemented reforms to place the fiscal house on a sounder footing. Major reforms to improve the revenue situation during the early part of the period.

### Table 2.3 Summary of Fiscal Sector Indicators: 2004-2010 (in million PhP)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenues</td>
<td>706,718</td>
<td>816,159</td>
<td>979,638</td>
<td>1,136,560</td>
<td>1,202,905</td>
<td>1,123,211</td>
<td>1,207,926</td>
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<tr>
<td>Tax Revenues</td>
<td>604,964</td>
<td>705,615</td>
<td>859,857</td>
<td>932,937</td>
<td>1,049,179</td>
<td>981,631</td>
<td>1,093,643</td>
</tr>
<tr>
<td>BIR</td>
<td>470,329</td>
<td>542,697</td>
<td>652,734</td>
<td>713,605</td>
<td>778,571</td>
<td>750,287</td>
<td>822,623</td>
</tr>
<tr>
<td>Others</td>
<td>7,366</td>
<td>8,352</td>
<td>8,962</td>
<td>9,893</td>
<td>10,360</td>
<td>10,360</td>
<td>11,037</td>
</tr>
<tr>
<td>Non-Tax Revenues</td>
<td>101,754</td>
<td>110,544</td>
<td>119,781</td>
<td>203,623</td>
<td>153,726</td>
<td>114,580</td>
<td>114,283</td>
</tr>
<tr>
<td>Total Disbursements</td>
<td>893,776</td>
<td>962,938</td>
<td>1,044,429</td>
<td>1,149,001</td>
<td>1,271,022</td>
<td>1,421,743</td>
<td>1,522,384</td>
</tr>
<tr>
<td>Current Operating Expenditures</td>
<td>755,748</td>
<td>831,716</td>
<td>904,179</td>
<td>947,357</td>
<td>1,031,849</td>
<td>1,141,967</td>
<td>1,229,785</td>
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<tr>
<td>Personal Services</td>
<td>283,065</td>
<td>296,361</td>
<td>324,690</td>
<td>350,291</td>
<td>374,662</td>
<td>414,023</td>
<td>469,402</td>
</tr>
<tr>
<td>MOOE</td>
<td>83,838</td>
<td>84,753</td>
<td>99,993</td>
<td>128,311</td>
<td>138,690</td>
<td>176,458</td>
<td>182,092</td>
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<tr>
<td>Subsidy</td>
<td>6,926</td>
<td>8,151</td>
<td>11,884</td>
<td>21,686</td>
<td>16,982</td>
<td>17,438</td>
<td>21,005</td>
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<tr>
<td>Allocation to LGUs</td>
<td>114,068</td>
<td>122,194</td>
<td>136,865</td>
<td>149,150</td>
<td>170,583</td>
<td>203,233</td>
<td>216,079</td>
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<td>Interest Payments</td>
<td>260,901</td>
<td>299,807</td>
<td>310,108</td>
<td>267,800</td>
<td>272,218</td>
<td>278,866</td>
<td>294,244</td>
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<tr>
<td>Capital Outlays</td>
<td>132,352</td>
<td>129,515</td>
<td>140,120</td>
<td>191,894</td>
<td>224,780</td>
<td>274,712</td>
<td>283,340</td>
</tr>
<tr>
<td>Net Lending</td>
<td>5,676</td>
<td>1,707</td>
<td>131</td>
<td>9,750</td>
<td>14,393</td>
<td>5,064</td>
<td>9,258</td>
</tr>
<tr>
<td>Fiscal (Deficit)/Surplus</td>
<td>(187,058)</td>
<td>(146,779)</td>
<td>(64,791)</td>
<td>(12,441)</td>
<td>(68,117)</td>
<td>(298,532)</td>
<td>(314,458)</td>
</tr>
</tbody>
</table>

*Sources: Bureau of Treasury (BTr), Department of Budget and Management (DBM)*

*Note: Table 2.3 was based on 2011 Fiscal Statistics Handbook and Cash Operations Report as of September 2010.*
included the revisions of the excise tax on alcohol and tobacco, an expansion of the scope and an increase in the rate of the value-added tax (VAT), as well as the enactment of the Lateral Attrition Law. As a result, tax effort rose from 12.5 percent in 2004 to 14.2 percent in 2008. The National Government (NG) reduced its deficit from an average of 3.9 percent of GDP in 2000-2004 to a more manageable 2.7 percent of GDP in 2005. This was further reduced to 1.1 percent in 2006 and was almost balanced in 2007 at 0.2 percent of GDP. The improved fiscal positions of the NG, the social security institutions, local governments, and the GFIIs translated into a surplus in the country’s consolidated public sector financial position amounting to PhP21.3 billion or 0.3 percent of GDP in 2007, from a deficit of PhP235.9 billion or 5.0 percent of GDP in 2004.

As economic activities slowed down owing to the recent global financial crisis, however, revenue collection weakened. Revenue effort dropped from 16.2 percent in 2008 to 14.6 percent in 2009, back to prereform levels. Tax effort dipped to 12.8 percent in 2009, the lowest in the ASEAN region, where it averaged 14.9 percent. In addition, several tax eroding measures were enacted in 2009 and 2010, which granted tax relief to various sectors, but depleting the revenues gained from earlier tax reforms. Revenues from taxes with specific rates also either remained flat or failed to rise in proportion with GDP because of the failure to index them. The share of excise taxes on “sin products” and petroleum barely changed during the period, from 21 percent of total revenues in 2004 to 22 percent in 2009.

Government’s ability to raise additional revenues from nontax sources has remained weak as well. Part of the problem lies in the governance challenges faced by GOCCs in their operations.

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Government’s ability to raise additional revenues from nontax sources has remained weak as well. Part of the problem lies in the governance challenges faced by GOCCs in their operations. Foremost of these are the multiple and often conflicting mandates; the various levels of oversight bodies; the need to update government

Figure 2.10  Year-on-Year Inflation Rate: 2004–2010

![Figure 2.10 Year-on-Year Inflation Rate: 2004–2010](source: Bangko Sentral ng Pilipinas (BSP))
ownership policy; the need to improve board governance; and the need to strengthen transparency and disclosure. The exemption of some GOCCs, including GFIs, from the Salary Standardization Law (SSL) granted by Congress, has provided authority to the boards of government corporations to adjust the compensation of their officials without restraint. Certain GOCCs also have mandates that are inconsistent with prudent fiscal behavior (e.g., they are used as subsidy providers and conduits for social services which were not compensated by the NG), while others have managed to exist only on the back of government subsidies.

In addition, many fees and charges for services have not been appropriately adjusted and in some cases, have even been lowered on request of the private sector (e.g., some fees and charges which affect exporters have been lowered to accommodate them). Collections from this source have not risen in line with the costs of providing the said services.

Table 2.4  Selected External Sector Accounts: 2004-2010 (In billion US$)

<table>
<thead>
<tr>
<th>Table 2.4 Selected External Sector Accounts: 2004-2010 (In billion US$)</th>
</tr>
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<tbody>
<tr>
<td>2004</td>
</tr>
<tr>
<td><strong>CURRENT ACCOUNT</strong></td>
</tr>
<tr>
<td>Goods and Services</td>
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<tr>
<td>% of GDP</td>
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<tr>
<td>Trade in Goods</td>
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<tr>
<td>Trade in Services</td>
</tr>
<tr>
<td>Income</td>
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<tr>
<td>Current Transfers</td>
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</tbody>
</table>

| **CAPITAL AND FINANCIAL ACCOUNT** | | | | | | |
| Capital Account | 9.2  | 11.4 | 13.2 | 14.2 | 15.2 | 16.2 | 16.6 |
| Financial Account | -1.6 | 2.2  | 0.0  | 3.5  | -1.6 | -1.6 | 7.9  |

| **BALANCE OF PAYMENTS** | | | | | | |
| Balance of Payments | -1.6 | 2.2  | 0.0  | 3.5  | -1.6 | -1.6 | 7.9  |

| **Gross International Reserves (GIR)** | | | | | | |
| GIR | 16.2 | 18.5 | 23.0 | 33.8 | 37.6 | 44.2 | 62.4 |

| % of short-term debt based on original maturity | 321.6 | 289.2 | 458.5 | 476.4 | 536.4 | 1105.5 | 1086.2 |
| % of short-term debt based on residual maturity | 163.0 | 164.6 | 251.3 | 300.7 | 333.2 | 500.5 | 575.1 |

| External Debt-to-GDP | 63.3 | 55.0 | 45.9 | 38.5 | 32.6 | 34.89 | 33.1 |
| Medium-to-long-term (% of total) | 90.8 | 88.2 | 90.7 | 87.2 | 87.0 | 92.7 | 90.4 |
| Short-term (% of total) | 9.2 | 11.8 | 9.3  | 12.8 | 12.9 | 7.3  | 9.6  |

Source: BSP (http://www.bsp.gov.ph, updates as of March 30, 2011)

a/ Refers to the adequacy of reserves to cover outstanding short-term external debt based on original maturity plus principal payments on medium-to-long-term loans of the public and private sectors falling due within the next 12 months
b/ Outstanding external debt as of September 2010
c/ January–September 2010
As the revenue position weakened and given the need to for a stimulus to counter the continuing recessionary pressure, the NG deficit in 2009 reached 3.9 percent of GDP while the consolidated public sector deficit was 3.3 percent of GDP in the same year. In 2010, the NG deficit to GDP ratio dropped to 3.7 percent from 3.9 percent in 2009 while the consolidated public sector deficit improved to 1.6 percent of GDP.

Some recent developments have been encouraging, however. Total revenues in 2010 rose by 7.5 percent from the previous year. Tax revenues were up by 11.4 percent due to improved performances by the Bureau of Internal Revenue (BIR) and Bureau of Customs (BoC) which had higher collections by 9.6 and 17.7 percent, respectively. Notwithstanding these, the revenue position still remains precarious as both the BIR and the BOC fell short of their respective targets in 2010. The postponement of privatization efforts, in the expectation of better terms and conditions, has reduced nontax revenues relative to the same period in 2009. Dividends and interest income have not increased sufficiently to offset the lack of proceeds from sale of assets.

Meanwhile, disbursements grew at a slower pace than revenues, increasing by 6.7 percent from the 2009 level compared to the 7.5 percent expansion in revenues. The increase can be attributed to the higher personal services requirements (13%) due to the continuing implementation of the SSL 3, the increased provision for the CCTs and the automated national and barangay elections, the carry-over disbursements from last year’s rehabilitation and reconstruction projects, and the higher provision for Internal Revenue Allotment (IRA) and interest payments.

Government spending contracted from 18.3 percent of GDP in 2004 to 17.2 percent of GDP in 2008 but has since increased to 18.5 percent of GDP as of 2009 given the government’s economic resiliency program (ERP). As a share to GDP, disbursements dropped to 17.9 percent in 2010.

The year 2010 was notable for the expenditure controls brought back by government, which enabled an orderly transition — from two years of fiscal stimulus in response to the global economic crisis — back to fiscal consolidation mode — as the global economic situation normalized. The tighter prioritization of expenditures with the application of the ZBB approach, and the calibration of allotment and cash releases in anticipation of revenue inflows were particularly helpful in this transition. But as the composition of expenditures and the quality of services improve, the absorptive capacity of the agencies and their capability to implement projects must be strengthened to spur economic activity and help create employment particularly in the countryside. The early approval of the Fiscal Year (FY) 2011 budget, the release of 100 percent of agency budgets in January 2011, as well as measures facilitating the procurement process were all intended to provide this spending jumpstart for the year. The closer monitoring of the rate of agency spending and absorption issues during the year should facilitate the identification of needed measures.

For the period 2004-2010, infrastructure outlays were given an increasing share of the budget, rising to 15.2 percent (2009), and remarkably higher by 4.7 percentage points than that in 2004. In 2010, infrastructure spending was 14.7 percent of total government expenditure. Similarly, the budget share of regular expenditure items necessary for more efficient operations of government increased by 2.6 percentage points from 9.4 percent in 2004 to 12 percent in 2010. Meanwhile, the budgetary requirement for interest payments was reduced from 29.2 percent of the
budget in 2004 to 20.7 percent in 2010. As a result, greater fiscal space was created for capital outlays and other productive expenditures.

For 2010, infrastructure and other capital spending grew more slowly by PhP6.5 billion or 3 percent year-on-year, given the lower obligation program for infrastructure and other capital outlays in 2010 compared to 2009. The growth is largely attributed to the carry-over disbursements for rehabilitation and reconstruction activities due to typhoon Ondoy in the latter part of 2009, and for other completed projects.

Disbursements were expanded in 2009 to counter the effects of the global economic slowdown and to provide additional relief, rehabilitation and reconstruction efforts prompted by the destructive calamities that hit the country. In 2010, total national government spending for the first three quarters amounted to PhP1.15 trillion, a 7.2-percent increase over that in 2009. The increase stemmed largely from spending on personal services, in compliance with mandated salary adjustments, and larger maintenance outlays. However, interest payments increased its share of the total budget from 19.6 percent to 21.2 percent after higher fiscal deficits reappeared. This higher deficit scenario, coupled with the weaker revenue effort, has constrained budgetary allocations to the economic and social sectors, which are vital for the achievement of faster and more inclusive economic growth over the medium term.

Low levels of spending on education, health and infrastructure largely and generally reflected the low level of government public expenditure. Low spending for social sectors caused poor outcomes in these areas and meant higher costs for the population who must spend for what government ought to have provided. NG spending on social services sector as a share of the budget declined from 28.9 percent to 27 percent in 2004 to 2007, recovering to 28.7 percent in 2009, and to 31.9 percent in 2010. Although spending on social services has gone up, the government still needs to increase its spending on priority sectors and reduce nonpriority expenditures if it is to keep pace with neighboring countries and close the gap in public spending.

Thus, generating sufficient revenues to support growth in the medium term remains the greatest challenge for the fiscal sector. More effort in revenue collection is needed so that an expenditure program more responsive to growth can be undertaken without bloating the country’s deficit and while still keeping the debt ratio at sustainable levels. Proactive debt management should also continue in order to reduce the debt service burden and to free up resources that could otherwise be channelled to more productive spending.

While the rules governing the contracting of debt and debt guarantees by agencies have recently been streamlined, some have failed to adhere to best practice and have contributed to the bloating of deficits. These instances include projects under build-transfer contracts whose fees and charges were kept unduly low for political reasons, those implemented and funded from government-to-government arrangements where accusations of overpricing are still being investigated, and automatic guarantees provided under the charters of some GOCCs.

GOCCs continue to be a large source of fiscal risk. As of end of 2008, their total liabilities (excluding those of the

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3 This is also the view of the recent Public Expenditure Review (PER) by the WB.
BSP) amounted to 36.9 percent of GDP. GOCCs are frequently directed to bear the cost of social programs that should ideally be funded out of the budget. A case in point is the NFA, which operates on a “buy-high-sell-low” policy. NFAs mandate to maintain floors for farm gate prices while keeping retail rice prices at reasonable levels virtually prevents the agency from recovering its cost. Public utilities like the Light Rail Transit Authority (LRTA) also face considerable financial constraints because user charges are maintained at levels that can only be maintained through heavy public subsidies.

Despite the power tariff increase in 2005 and the privatization of the generating assets and the offloading of the operation and investment responsibilities for both the power plants and transmission assets to the private sector, the National Power Corporation (NPC) and the Power Sector Assets and Liabilities Management Corporation (PSALM) remain sources of fiscal risk. The full implementation of the universal levies, provided for under the Electric Power Industry Reform Act (EPIRA) will play a major role in mitigating the fiscal risks from the power sector.

**Monetary and External Sectors**

**Prices**

Inflation in the Consumer Price Index (CPI) averaged 5.6 percent for the period 2004-2010 with a declining trend, averaging 3.8 percent in 2010. From 2004 to 2006, much of the inflation pressure was due to supply shocks, including increases in global oil prices that led to higher domestic pump prices, minimum wage adjustments throughout the country, hikes in transport fares and utility charges, and weather-related disturbances. Meanwhile, with good weather conditions and a relatively firm peso, inflation declined to 2.8 percent in 2007, the lowest annual average in 21 years.

The steady decline in inflation was interrupted by sharp increases in world commodity prices, which fed into a 9.3-percent inflation rate in 2008. Monetary authorities responded by raising the policy rate by 100 basis points for June-August 2008. By late 2008, the balance of risks to the inflation outlook had shifted downwards following the easing of commodity prices, the moderation in inflation expectations, and the slowdown in economic activity. These developments provided latitude for monetary easing to support growth amidst the global financial crisis in 2008-2009, including the 200-basis point reduction in policy interest rates. Monetary authorities also adopted other crisis intervention measures at the height of the global financial crisis and smoothly disengaged from these when financial conditions began to normalize. 

The monetary policy stance remains supportive of noninflationary growth. Credit remains adequate in supporting economic activity. This is evident in the steady uptrend in bank lending and smooth functioning of domestic financial markets. Low and stable inflation has also contributed to lower costs of funds in the

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4 In addition to the 200-basis point reduction in the BSP policy rate, other measures included the: (a) opening of US dollar repo facility; (b) increase in rediscounting budget from PhP20 billion to PhP60 billion; (c) the reduction in banks’ reserve requirement by two percentage points; and (d) some easing of the loan value and access criteria to the rediscounting facility. The BSP later disengaged from these measures. It aligned the peso rediscount rate to the BSP’s policy rate, restored the peso rediscounting budget to its precrisis level of PhP20 billion and restored the loan value and the past-due loan ratio requirements for banks availing themselves of the rediscounting facility to their precrisis settings.
market, supporting investment and consumption expenditures by firms and households.

**External Sector**

The current account balance as a ratio of GDP has increased from 1.9 percent in 2004 to 4.5 percent in 2010. The current account position has shifted to structural surpluses in large part due to the resilience of overseas remittances, increased services receipts from business process outsourcing, and steady tourism receipts. These sources of foreign exchange inflows have been more stable than investment flows. Driven by the surplus in the current account and the improvement in capital and financial account, the balance of payments has also registered surpluses since 2005.

However, merchandise exports growth performance was relatively volatile, reflecting the country’s vulnerability to global developments. The annual average export growth for 2004-2010 was 6.5 percent, which was pulled up by the 34.8-percent growth in 2010 as the global economy began to recover.

Meanwhile, the exports of services have been on an uptrend, mainly on account of transportation, travel, and other business, technical, and professional services. Merchandise imports outpaced exports, with more than 60 percent of total imports consisting of raw materials and intermediate goods, and capital goods.

Overseas Filipino (OF) remittances have been steadily growing even when the global financial crisis broke out. In 2010, remittances coursed through banks amounted to US$18.8 billion, an increase by 8.2 percent from the level recorded in previous year.

The country’s favorable external position has also been supported by the continued improvement in the country’s external debt profile. The Philippine external debt-to-GDP ratio was 63.3 percent in 2004. As of September 2010, this ratio was down to 33.1 percent. The long-dated maturity structure of the country’s foreign currency debt has helped to limit rollover and foreign exchange risks.

With the strong external payments performance, international reserves have risen, providing strong coverage for both imports and short-term external debt. At end-December 2010, the gross international reserves (GIR) stood at US$62.4 billion, based on preliminary data. This level of GIR could cover 10.3 months of imports of goods and services, and was equivalent to 10.8 times the country’s short-term external debt based on original maturity and 5.7 times based on residual maturity. The comfortable level of foreign exchange reserves provides a strong cushion that helps the economy withstand external shocks.

As a result of the strong external liquidity position, the Philippine peso has remained broadly stable. The trends in the real effective exchange rate (REER) show that the peso has lost some competitiveness against major trading partners compared to six years ago. In the last two years, however, the peso gained competitiveness against baskets of competitor currencies (both broad and narrow) owing to the narrowing of the inflation differential, which offset the nominal appreciation of the peso.

**Challenges**

The Philippine economy nonetheless faces a number of issues and challenges that may warrant monetary policy actions.

**Capital Inflows**

Bright prospects for emerging economies combined with the prolonged accommodative monetary policies in advanced economies have driven large
capital inflows into emerging economies, including the Philippines. Foreign capital inflows can be an important source of funds for investment expenditures but also entail risks that need to be closely monitored and addressed when warranted. Huge capital inflows can contribute to excessive liquidity growth, cause asset market imbalances, and lead to inflation pressures that can complicate monetary policy.

**Asset Market Imbalances**

Asset price dynamics are an important consideration in the pursuit of price stability by monetary authorities. The build-up of asset market imbalances contributes to financial stability risks that can harm economic activity, and in turn affect the outlook for price developments. The recent global financial crisis resulted in a deep economic downturn which became a major source of downside risk for the inflation outlook in advanced economies. Furthermore, financial markets provide an avenue through which monetary policy actions are transmitted to the real economy. Vulnerabilities stemming from the financial sector as a result of asset price bubbles can complicate and reduce the effectiveness of monetary, fiscal, and regulatory policies. While monetary authorities remain focused on achieving low and stable inflation, they will continue to be highly attentive and alert to credit growth, asset price developments, and financial imbalances which can have implications on financial stability and ultimately, on price stability. Monetary authorities will also continue to employ macroprudential tools to help prevent overheating and undue risk-taking in asset markets. Macroprudential regulations already in place have thus far helped make the economy less prone to asset price escalations. These regulations include the statutory limit on the share of real estate loans to banks’ total loan portfolio and the maximum loan-to-value ratio for real estate loans.

**Global Commodity Prices**

Volatile and rising global prices of key commodities can have significant impact on domestic prices. While these are mainly supply shocks in nature, they may lead to second round effects that could result in elevated inflation expectations. Monetary authorities will continue to coordinate with other government agencies to temper the impact of global commodity price shocks on domestic prices. Monetary authorities will remain vigilant and ready to implement timely policy adjustments in response to the emergence of second-round effects on inflation.

**Strategic Framework**

To achieve the overarching goal of inclusive growth, government lays down the conditions for a stable macroeconomic environment that is conducive to sustaining a higher growth path. For fiscal policy, the main task is to expand the narrow fiscal space and to get on a sustainable revenue-and-spending path. For monetary sector and external sector policies, this means commitment to low and stable inflation conducive to balanced and sustainable growth and reduced external vulnerabilities.

**Fiscal Reforms**

One of the most important tasks that need to be addressed in order to achieve macroeconomic stabilization is to put order in the fiscal house. The large budget deficits incurred as a result of the fiscal stimulus during the global economic and financial crisis resulted in the need for fiscal consolidation. At the same time, the reduction of spending for infrastructure and social services as a result of the government’s expenditure compression efforts in 2002 to 2006, has resulted in large financing gaps in these areas. These financing gaps, in turn, not only

Bright prospects for emerging economies combined with the prolonged accommodative monetary policies in advanced economies have driven large capital inflows into emerging economies, including the Philippines.
constrained the country’s economic growth, but also limited the access of the poor to the economic gains the country has achieved. The challenge in the medium term, therefore, is one of achieving fiscal consolidation, while at the same time substantially increasing the country’s investments in infrastructure, health, and education.

The overall strategy in the fiscal sector in the medium term is to increase tax effort to 15.6 percent of GDP. This is to be achieved through an annual incremental 0.3 percentage point annual rise in the collection effort of BIR, and 0.1 percentage point for the BOC. At the same time, nontax revenue collection would be increasing equivalent to an average of 1.2 percent of GDP through governance reforms. Correspondingly, the NG deficit should decline to a level of 2 percent of GDP by 2013 and must be maintained at this level until 2016. Also, beginning 2013, the consolidated public sector deficit must be brought down to 1.5 percent of GDP. The specific strategies and programs designed at achieving the abovementioned targets are detailed below.

**Tax Administration Reforms**

Before even attempting to introduce structural reforms into the country’s tax system, administrative reforms must be given priority. Numerous reform measures are being lined up to improve tax administration. These measures include the following:

1. Establishing a tax registry comprehending all taxpayers;
2. Using comprehensive third-party data to determine the potential tax base;
3. Maintaining a transparent and productive tax audit program;
4. Fully staffing the BIR and BOC with competent and adequately trained personnel;
5. Formulating transparent and consistent tax rulings;
6. Revitalizing the RATE, RATS and RIPS programs of government;
7. Establishing appropriate performance standards and evaluation; and
8. Instituting a more effective system of rewards and penalties under the Lateral Attrition Law backed up by performance standards.

**Tax Policy Reforms**

To complement the efforts to improve tax administration and to ensure that revenues are adequately protected, priority policy reforms need to be instituted, namely: the rationalization of the fiscal incentives system and the enactment of a fiscal responsibility law. The rationalization of fiscal incentives will save revenues for the government by doing away with redundant incentives (e.g., those directed at investments that would have taken place even with the absence of such incentives). At the same time, rationalization will allow the government to direct the incentive system at the export sector so that its full potential can be realized.

A fiscal responsibility law is necessary to hasten the fiscal consolidation process and enforce fiscal discipline at all levels of government. The fiscal position of government should be kept on an agreed deficit path. Such a law is also necessary to keep the country’s debt at a manageable level.

With proper timing, other tax reforms need to be undertaken in order to improve the revenue take of the tax system while promoting equity and a level playing field for all stakeholders. Priority must be
given to adjustments in the excise tax on alcohol and tobacco products, as well as the excise tax on petroleum. The use of the so-called PAYGO system as a collection handle must also be maximized.

The distortions of the tax system caused by the enactment of piecemeal exemption laws must be corrected. A reversal of these unnecessary tax exemptions must be pursued in order to restore the integrity of revenues and make the tax system more efficient and equitable.

Nontax Revenue Reforms

Fees and charges collected by government agencies have not been adjusted since a decade ago. Consistent with the sound principle of cost recovery, these fees must be adjusted to cover the cost of administering government services.

Government must aggressively pursue the auctioning of its assets such as air frequencies and permits to develop renewable energy resources. GOCCs must also be made to contribute their fair share to the revenue effort by, among others, promptly remitting dividends.

Expenditure Policy Reforms

The key challenge in the area of expenditure policy is how to substantially increase productive expenditures, such as those for infrastructure and social services (e.g., education and health) – and catch up with the accumulated investment deficits in these areas – while at the same time aggressively reducing wasteful and inefficient expenditures.

In order to address this challenge, the Plan envisions the implementation of several major public expenditure management reforms not only to help narrow the fiscal deficit over the medium term but also ensure that resources are allocated to priority investments, such as human capital and infrastructure. Toward this end, expenditure reforms that have been introduced in the recent years will be strengthened and in some cases, revitalized, in order to improve resource allocation and build results-orientation into the government service. Among these reforms are the following:

1. Medium-Term Expenditure Framework (MTEF). The continued adoption of the multiyear budgeting system (the MTEF) will improve the predictability of funding, and integrate policy with resource allocation. The main components of the MTEF are the Paper on Budget Strategy (PBS) and the Forward Estimates (FEs).

   - **The Paper on Budget Strategy** will link budget allocation with the national agenda of the government to identify the priority areas for spending, and to incorporate the sectoral and regional implications in the

---

5 In the health sector, the country’s public expenditure per capita on health was US$39 in 2006, compared to the median of US$88 per capita expenditures for comparable East Asian countries. Overall, the Philippine NG spending on social safety net programs was a mere 0.3 percent of GDP in 2007 and 0.8 percent of GDP in 2008, which is less than half of the mean expenditure on social welfare programs of 1.9 percent of GDP in a group of 87 countries.
dimension and distribution of the budget; and

- **Forward Estimates (FEs)** are the estimated annual costs of ongoing programs and projects. These will help ensure the continuous funding of program requirements beyond a given fiscal year, and help provide a sound basis of future years’ budget trends. In order to adopt more rigid and realistic FEs, the government will pursue automation that is linked to existing budget application systems and to the PDP and PIP.

2. **Organizational Performance Indicator Framework (OPIF).** This enables the channelling of resources to where it best produces the desired results and outcomes, as indicated by agreed upon performance indicators. The implementation of the OPIF will be cascaded to the operating units of the agency, in order to sustain the restructuring of government expenditures to the priority sectors. The linking of the OPIF and Performance Management System-Office Performance Evaluation System (PMS-OPES) being spearheaded by the Civil Service Commission, will allow the institution of a performance-based compensation system.

3. **Fiscal Responsibility Bill (FRB).** The DBM and DOF shall work together to revive the FRB initiative dating back to 2004 and shall push for its approval. The bill aims to strengthen fiscal discipline in the public sector by prescribing principles of responsible fiscal management, establishing control mechanisms on spending, and adopting preventive measures against the erosion of the tax base of the government. One of its prominent features is ensuring that proposals to grant fiscal incentives or permanent increases in national government expenditures must be offset by permanent increases in revenue or permanent reductions in other expenditures.

4. **Government Rationalization Program (RP).** Executive Order (EO) No. 366 issued on October 4, 2004 aims to build a smaller bureaucracy and improve public service delivery through the strategic review of the mandates, operations, organizational structures, functions, programs and activities of national government agencies; the elimination of overlapping or duplicating functions; and the focusing of government efforts and resources towards its core or vital functions. Given the current progress in rationalizing half of the agencies in the Executive Branch, its continuation is expected to lead to the elimination of 12,549 regular positions, saving the government some PhP2.4 billion in annual salaries and compensation.

5. **Procurement Reforms.** Significant progress was made in reforming the procurement system through the passage in 2003 of Republic Act (RA) No. 9184 or the Government Procurement Reform Act. Aside from standardizing and modernizing the procedures in government purchasing, the law also requires the use of the Philippine Government Electronic Procurement System (PhilGEPS) by all government entities, which serves as the sole portal hosting sources of information on all government procurement. From 2011, the following functionalities in the PhilGEPS will be implemented: (a) virtual store for electronic purchasing; (b) expanded supplier registry as a centralized electronic database of all manufacturers, suppliers, distributors, contractors and consultants registered in the system; (c) introduction of charges and fees to sustain operations and maintenance of the system; (d)

The Plan envisions the implementation of several major public expenditure management reforms not only to help narrow the fiscal deficit over the medium term but also ensure that resources are allocated to priority investments, such as human capital and infrastructure.
e-payment system to enhance the functionality of the virtual store; (e) e-bid facility for electronic bid evaluation of all types of procurement for goods, infrastructure projects and consulting services; and (f) uploading of the individual Annual Procurement Plan (APP) of each government procuring entity. Public procurement in the country shall continue to adapt to improvements in modern technology through introduction of future functionalities in the PhilGEPS that will facilitate service delivery, transparency and competitiveness in the public procurement system.

6. Stronger Internal Control System (ICS). Along with procurement reforms, the internal control system of government entities is being strengthened to reduce waste and corruption. The DBM, in partnership with the Office of the President–Internal Audit Office has issued the National Guidelines on Internal Control System (NGICS). The NGICS serves as a guide to departments/agencies in redesigning, installing, implementing and monitoring their respective ICS, taking into consideration the requirements of their organization and operations. A government Internal Audit Manual (PGIAM), consistent with the NGICS, will soon be finalized in order to assist the government in establishing fully functioning internal audit offices in the public sector.

The government will find more ways to further strengthen public expenditure management with the following expenditure reforms and initiatives:

7. Zero-Based Budgeting (ZBB) Approach. Anchored on the good governance thrust of the Aquino administration, the Department of Budget and Management (DBM) led the review and evaluation of ongoing programs and projects through the ZBB approach in preparing the 2011 Budget. Complementing the MTEF and the OPIF, the ZBB approach is geared towards assessing the continued relevance and priority of programs; ascertaining whether the program objectives and outcomes are being achieved; identifying alternative or more effective and efficient ways of achieving the objectives; and guiding decisions whether the resources for the program or project should continue to be provided at present levels, increased, reduced, or discontinued.

Initial findings and recommendations from the conduct of ZBB exercises during the preparation of the 2011 Budget include:

- Termination of programs no longer delivering intended outputs and outcomes;
- Holding of the funding for some programs pending removal of bottlenecks in project implementation and procurement;
- Expansion of well-performing programs to alleviate or mitigate critical gaps in social and economic services;
- Recommendation on the implementation of difficult reforms in GOCCs;
- Stricter controls in the use of lump-sum funds following master plans and government priorities; and
- Deactivation of selected agencies and GOCCs.

In succeeding budget processes, the government shall widen the scope of the evaluation of the major programs/projects under the ZBB approach to build up capacity, and to institutionalize program evaluation in the government.
8. Transparency and Accountability Safeguards in the Budget Process. The overarching goal is to enhance transparency and enforce accountability in government operations by incorporating general and special provisions in the General Appropriations Act (GAA). Under the 2011 GAA, all departments and agencies, including those enjoying fiscal autonomy, are required to post their approved budgets on their websites and the status of their programs/projects starting 2011. Special provisions in the budgets of agencies and GOCCs with key programs and projects require the posting of the details of program beneficiaries and locations of projects on their websites for better information and appreciation of the public. This practice also allows the public to verify agency outputs vis-à-vis targets.

9. Public Financial Management (PFM) and the Government Integrated Financial Management Information System (GIFMIS). This initiative aims to harmonize and integrate the budgeting, accounting, and auditing systems of the government. Reforms in the PFM system will make it more transparent, accountable, and performance-oriented. A Memorandum of Agreement (MOA) has been executed between the DBM, Commission on Audit (COA) and BTr to develop the GIFMIS.

10. Contingent Liability Management (CLM). Considering the fiscal impact of realized contingent liabilities (CL) from existing BOT and GOCC projects that are guaranteed by NG, a joint ICC-DBCC resolution will be issued to strengthen CLM through the preparation of the CLM Plan by implementing agencies, training for value analysis/value engineering and CL assessment, evaluation by the DOF of CL for every financing/procurement option, and full disclosure of required budget for CL that will become real liabilities and will thereby need funding.

11. Timely Approval of the Annual Budget. Addressing the urgent needs of agencies in a timely and predictable manner is the main reason that the government pushes for the passage and approval of the GAA before the fiscal year starts. To be able to do this, the government revised its budget schedule in anticipation of early budget preparation activities to

| Table 2.5 Selected Fiscal, Monetary, and External Medium-Term Targets: 2011-2016 |
|----------------------------------|-----|-----|-----|-----|-----|-----|
| Fiscal Balance (% of GDP)        | -3.2| -2.6| -2.0| -2.0| -2.0| -2.0|
| Inflation rate (%)               | 3.0-5.0 a/ | 3.0-5.0 b/ | 3.0-5.0 b/ | 3.0-5.0 b/ | n.a. | n.a. |
| Exports (US$Bn) c/               | 55.3 – 55.8 | 62.5 | 71.3 | 81.3 | 94.3 | 109.4 |
| Growth rate (%)                  | 9.0 – 10.0 | 12.0 | 14.0 | 14.0 | 16.0 | 16.0 |
| Imports (US$Bn) c/               | 71.5 – 72.1 | 85.1 | 100.4 | 118.5 | 141.0 | 167.8 |
| Growth rate (%)                  | 17.0 – 18.0 | 18.0 | 18.0 | 18.0 | 19.0 | 19.0 |

a/ Approved under DBCC Resolution No. 2009-10 dated 27 November 2009.

b/ Approved under DBCC Resolution No. 2010-3 dated 09 July 2010. The BSP shifted from a variable annual inflation target to a fixed medium-term inflation target of 4 ± 1 for 2012-2014.

c/ Approved by the Monetary Board on 24 March 2011.
give ample time for the DBM and the agencies to conduct consultations with sectoral groups, civil society organizations (CSOs), and Regional Development Councils (RDCs). The new schedule, coupled with improved budget documents submitted to Congress, will facilitate the budget legislation process, hence ensure timely enactment of the annual budget.

12. Rationalization of GOCCs and GFIs. To better streamline the budgetary support given to GOCCs/GFIs, the government has embarked on instituting reforms to reduce their financial vulnerability and improve service delivery. The DOF and the DBM are collaborating in the passage of a law to strengthen oversight functions on GOCCs/GFIs, and to create a Government Corporate Council that will effectively manage and supervise the operations of these entities. Administrative and legislative measures will also be proposed to amend or restructure GOCC charters. A review of the compensation granted to board members, officers, and employees of GOCCs and GFIs will also be undertaken to control costs of personal services in GOCCs and make compensation equitable relative to that in the National Government.

Monetary Policy and External Sector Reforms

Monetary policy will remain committed to the achievement of low and stable inflation that is conducive to a balanced and sustainable growth of output and employment. This stance entails continuous macroeconomic surveillance efforts for a more effective management of risks. At the same time, monetary authorities will continue to improve their communication of policy intentions and actions.

In recent years, monetary authorities have implemented a number of reforms to enhance the effectiveness of the monetary policy framework. In 2006, the way the inflation target was arrived at was changed from specifying a range to specifying a point with a tolerance interval which effectively widened the BSP’s target band. A broader target band provides added flexibility to monetary authorities in steering inflation, particularly in the domestic setting where consumer prices are subject to large supply shocks because of the sizeable share of food items in the consumer basket. The economic policymakers also announced in 2010 the shift to a fixed...
medium term inflation target from a variable annual inflation target. The adoption of a fixed medium-term inflation target aims to promote a long-term view of inflation, help better anchor inflation expectations, and support consumption and investment by fostering greater predictability in economic decisions (Table 2.5).

The monetary authority’s reform agenda will focus on improving the institutional set-up and fine-tuning the procedures of inflation targeting. Key measures to be pursued for more effective inflation management include the following:

a. Given the interdependent real and financial markets across the globe and the risks involved, the BSP shall pursue the expansion of its monetary policy toolkit to enhance the flexibility and efficiency of its monetary operations with a view to safeguarding both price and financial stability.

b. Pursuant to the provisions of RA 7653, the monetary authorities will request the full capitalization of the BSP to ensure that financial losses from time to time do not deter the BSP from fulfilling its mandate of maintaining price stability. A bigger capital base will enhance the BSP’s financial autonomy and credibility, giving more confidence to the market.

Enhancing the link to financial stability. The economic downturn resulting from the recent global financial crisis brought to light the importance of policy coordination in promoting macroeconomic stability. The close coordination of monetary, regulatory, and fiscal policies was critical to the restoration of global financial stability. This, in turn, paved the way for business confidence to improve and ultimately, for economic recovery to take root. Interaction of different policies is likely to remain the new modus operandi for economic policy markers. In this regard, promoting closer coordination of macroeconomic and financial sector policies could be explored, including through a wider representation in the Financial Sector Forum (FSF).

On the external sector, policymakers will continue to adopt appropriate measures that will cushion the economy from external shocks as well as ensure the health of the country’s external payments position and the sustainability of its external debt over the medium-term.

The foreign exchange regulatory framework will be further reviewed to keep it responsive to the needs of an expanding and increasingly integrated economy. Since 2007, the monetary authorities have undertaken four major phases of foreign exchange reforms. The reforms brought greater access to foreign exchange resources for trade, investment and other foreign transactions. The measures also facilitate the diversification of investment portfolios and help reduce the economy’s vulnerability to shocks.

The country’s external debt shall be maintained at more manageable and sustainable levels. This shall entail appropriately designing the external debt structure to minimize risks emanating from currency and maturity mismatches.

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6 The Financial Sector Forum (FSF) in an interagency body composed of the BSP, Securities and Exchange Commission (SEC), Insurance Commission (IC), and the Philippine Depository Insurance Corporation (PDIC). The FSF principally provides an institutionalized framework for coordinating the supervision and regulation of the financial system, for strengthening the exchange of information among the different regulators, and for the promotion of better consumer protection.
With respect to the NG, it will review the country’s sovereign bonds and debt profile to identify which instruments shall be eligible for its bond exchange program. This program aims to boost liquidity sourced from longer-dated securities and to provide long-term financing for government initiatives promoting PPP for infrastructure and economic development.

The monetary authorities will also endeavour to maintain the external debt stock and the external debt service burden at sustainable levels. This will entail continuing the comprehensive and regular monitoring of the level and maturity profile of the country’s external debt and the conduct of debt sustainability assessments.

Complementing the sound management of external debt level, the monetary authorities will also build cushions against shocks by promoting an adequate level of international reserves.

Furthermore, policymakers will need to focus on leveraging remittances as a tool for economic development. While remittances are private transfers, the government can ensure that the policy environment is conducive to the use of remittances for investment in well-considered financial products, in productive activities such as entrepreneurial undertaking as well as in better housing, education, and healthcare for remitters and their beneficiaries. Improving the financial education of the overseas Filipino community and implementing measures to further promote the flow of remittances through the financial system would help catalyze the developmental role of remittances.